185 (3)

No. 10-898

In the Supreme Court of the United States

PRINCO CORPORATION, ET AL., PETITIONERS

v.

INTERNATIONAL TRADE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE INTERNATIONAL TRADE COMMISSION IN OPPOSITION

JAMES M. LYONS
General Counsel

WAYNE W. HERRINGTON
Assistant General Counsel

CLARA KUEHN
Attorney
International Trade Commission
Washington, D.C. 20436

NEAL KUMAR KATYAL
Acting Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
SupremeCtBriefs@usdoj.gov
(202) 514-2217

QUESTION PRESENTED

The International Trade Commission entered an order excluding petitioners' products from the United States on the ground that they infringed patents held by respondent U.S. Philips Corporation. The question presented is as follows:

Whether petitioners presented to the Commission the theory of patent misuse that they urged to the en banc court of appeals in seeking review of the Commission's order.

TABLE OF CONTENTS

Page

Opinions below 1
Jurisdiction 1
Statement 2
Argument 22
Conclusion 31

TABLE OF AUTHORITIES

Cases:

Addamax Corp. v. *Open Software Found., Inc.*, 152 F.3d 48 (1st Cir. 1998) 18

Major League Baseball Props., Inc. v. *Salvino, Inc.*, 542 F.3d 290 (2d Cir. 2008) 19

Rothery Storage & Van Co. v. *Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986), cert. denied, 479 U.S. 1033 (1987) 18

Texaco Inc. v. *Dagher*, 547 U.S. 1 (2006) 10

United States v. *L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33 (1952) 23

Windsurfing Int'l, Inc. v. *AMF, Inc.*, 782 F.2d 995 (Fed. Cir.), cert. denied, 477 U.S. 905 (1986) 18, 29

Zenith Radio Corp. v. *Hazeltine Research, Inc.*, 395 U.S. 100 (1969) 14, 17

Statutes and regulation:

Tariff Act of 1930, 19 U.S.C. 1202 *et seq.*:

19 U.S.C. 1337 ..... 2, 4, 5, 6, 9, 17

19 U.S.C. 1337(a)(1)(B) 4

19 U.S.C. 1337(c) 30

19 U.S.C. 1337(d) 30

Statute and regulation—Continued: Page

35 U.S.C. 271(d)(5) 7, 8, 9
19 C.F.R. 210.43(b) 6

Miscellaneous:

9 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (2d ed. 2004) 12
67 Fed. Reg. 48,948 (2002) 4
68 Fed. Reg. 70,036 (2003) 6
69 Fed. Reg. 12,711 (2004) 6
72 Fed. Reg. 6286 (2007) 2
United States Dep't of Justice & Fed. Trade Comm'n, *Antitrust Guidelines for the Licensing of Intellectual Property* (1995) 10

In the Supreme Court of the United States

No. 10-898

PRINCO CORPORATION, ET AL., PETITIONERS

v.

INTERNATIONAL TRADE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE INTERNATIONAL TRADE COMMISSION IN OPPOSITION

OPINIONS BELOW

The en banc opinion of the court of appeals (Pet. App. 1a-88a) is reported at 616 F.3d 1318. The panel opinion of the court of appeals (Pet. App. 1b-59b) is reported at 563 F.3d 1301. The decision of the International Trade Commission (Pet. App. 1c-158c) is unreported. An earlier opinion of the court of appeals (Pet. App. 1d-42d) is reported at 424 F.3d 1179. An earlier decision of the International Trade Commission (Pet. App. 1e-89e) is unreported. The decision of the administrative law judge is unreported.

JURISDICTION

The judgment of the court of appeals was entered on August 30, 2010. On November 1, 2010, the Chief Jus-

tice extended the time within which to file a petition for a writ of certiorari to and including December 29, 2010. On December 20, 2010, the Chief Justice further extended the time to January 5, 2011, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This case arises from the International Trade Commission's final determination on remand in Investigation No. 337-TA-474, *Certain Recordable Compact Discs and Rewritable Compact Discs*. That proceeding was instituted by the Commission on July 26, 2002, in response to a complaint filed by respondent U.S. Philips Corporation (Philips), and was conducted by the Commission under Section 337 of the Tariff Act of 1930, ch. 497, 19 U.S.C. 1337 (Section 337). The Commission determined that certain of petitioners' products—recordable compact discs (CD-Rs) and rewritable compact discs (CD-RWs)—infringed six of Philips's patents, and it accordingly ordered those products excluded from the United States. Pet. App. 1c-158c; 72 Fed. Reg. 6286 (2007). The en banc court of appeals affirmed. Pet. App. 1a-88a.

1. The technologies at issue in this case are blank digital storage media known as CD-Rs and CD-RWs. As the court of appeals explained, "[t]he companies that developed the CD-R/RW technology generated technical standards to ensure that discs made by different manufacturers would be compatible and playable" on a variety of machines. Pet. App. 5a. Those standards "were collected in a publication entitled 'Recordable CD Standard,' informally known as the 'Orange Book.'" *Ibid.* The technology and the Orange Book standards were

"developed principally by Philips and Sony Corporation." *Ibid.*

Among other technical challenges, "the Sony and Philips engineers had to address the problem of how to encode position information in the disc so that a consumer's CD reader/writer could maintain proper positioning while writing data to the disc." Pet. App. 5a. Philips proposed one solution, which is disclosed in U.S. Patents No. 5,023,856 and No. 4,999,825 (the Raaymakers patents). Sony proposed a different solution, which is disclosed in U.S. Patent No. 4,942,565 (the Lagadec patent). *Id.* at 5a-6a, 9b-10b. "The engineers from both companies agreed that the Raaymakers approach was simple and worked very well. By contrast, as the Commission found * * *, the Lagadec approach was prone to error and would have been very difficult to implement." *Id.* at 6a (ellipsis and internal quotation marks omitted). "Philips and Sony therefore incorporated the Raaymakers approach in the Orange Book." *Ibid.*

To commercialize CD-R/RW technology, Philips and Sony "offer[ed] licenses to the patents that were required to manufacture CD-R/RW discs in accordance with the Orange Book standards." Pet. App. 6a. Among those were package (or "pool") licenses to patents "potentially necessary to make Orange-Book-compliant CD-R or CD-RW discs, including the Raaymakers and Lagadec patents."[1] *Ibid.*

In order to manufacture and import such discs, petitioners obtained a package license from Philips. When

---

[1] The CD-R pool includes the patents of Philips, Sony, and Taiyo Yuden. The CD-RW pool includes the patents of Philips, Sony, and Ricoh. C.A. App. 515-516. Only Philips was a party to the Commission investigation.

petitioners stopped paying license fees, Philips filed a Section 337 complaint with the Commission, which has jurisdiction to restrain "[t]he importation into the United States * * * of articles that * * * infringe a valid and enforceable United States patent." 19 U.S.C. 1337(a)(1)(B); see Pet. App. 7a.

2. The Commission instituted an investigation. 67 Fed. Reg. 48,948 (2002). After a full evidentiary hearing, the Commission's administrative law judge (ALJ) determined that (1) the accused products infringed the Philips patents, (2) the domestic-industry requirement of Section 337 had been satisfied, and (3) none of the claims in issue of the Philips patents were invalid. C.A. App. 154-291, 374-508. The ALJ nonetheless found no violation of Section 337 because he concluded that the Philips patents were unenforceable by reason of patent misuse. *Id.* at 292-373, 509-600. Only a few aspects of that lengthy determination are relevant here.

First, petitioners (and the other respondents in the Commission's investigation, who are not parties in this Court) did not mention the Lagadec patent in their post-hearing brief on patent misuse or in their proposed findings of fact and conclusions of law on patent misuse.

Second, petitioners argued that some of Philips's asserted patent claims were invalid as anticipated or made obvious by the Lagadec patent. See C.A. App. 270-277. The ALJ disagreed, finding that "[t]he Lagadec patent's disclosure in fact exhibits several problems that the * * * method disclosed in [one of the Raaymakers patents] was designed to solve." *Id.* at 274. He further found that

> [i]n addition to expert testimony, the record also contains evidence of actual industry concerns about the

> prior art methods. Philips and Sony considered, and rejected, the digital method as disclosed in Lagadec because it requires a high bandwidth signal that interferes with the low frequency servo signal from the pregroove as well as the information later recorded on the disc. * * * It is [not] possible to filter out these interfering frequency components completely because the low frequencies also carry the position information. * * * Lagadec's digital method has the additional shortcoming that it leaves no room for error detection encoding in the system and, as a result, is very prone to errors.

Id. at 274 n.87 (internal quotation marks and citations omitted). The ALJ made corresponding findings of fact about the Lagadec technology's serious shortcomings, finding that it was inherently "prone to errors and decoding is difficult to carry out." *Id.* at 470, 471.

Finally, the ALJ found no violation of Section 337 because he concluded that Philips's patents were unenforceable for patent misuse. That determination rested on two theories of misuse per se—price fixing and price discrimination—that turned on the price and terms of the CD-R/RW package licenses. See C.A. App. 308-335. The ALJ also found misuse on two theories under the rule of reason. First, the ALJ concluded that it was anticompetitive for Philips and the other patent holders to include in the pool certain patents—including the Lagadec patent—that were not essential to practicing the Orange Book standards. See *id.* at 335-366.[2] Second, again focusing on the price and terms of the pack-

---

[2] The Commission's investigative attorney, but not petitioners, had argued that the Lagadec patent was a "non-essential" patent that Philips had improperly included in the pool. See C.A. App. 349-350.

age licenses, the ALJ concluded that the "anticompetitive effects of the royalty rate structure of the CD-R/RW patent pools far outweigh the procompetitive effects suggested by [Philips]." *Id.* at 372; see *id.* at 366-372.

The ALJ did not specifically determine whether Philips and Sony had agreed that the Lagadec patent would not be available for licensing outside the pool for a purpose different from (and potentially competitive to) producing CD-R/RW discs according to Orange Book standards. Nor did the ALJ reach any legal conclusion about what significance such a determination would have had for petitioners' misuse defense.

3. Philips petitioned for Commission review of the ALJ's patent-misuse determinations, and the Commission determined to review all of the ALJ's findings of fact and conclusions of law on patent misuse. 68 Fed. Reg. 70,036 (2003).[3] After receiving briefing, the Commission agreed with the ALJ (albeit on partly different reasoning) that because of Philips's patent misuse there was no violation of Section 337. 69 Fed. Reg. 12,711 (2004); Pet. App. 1e-89e.

In particular, the Commission concluded that the Philips patents were unenforceable for patent misuse per se, on the theory that Philips's practice of mandatory package licensing was a tying arrangement between (1) licenses to patents essential to manufacture Orange Book-compliant CD-Rs or CD-RWs and (2) licenses to certain other patents the Commission found

---

[3] No party petitioned for review of the ALJ's resolution of other issues, such as validity and infringement. Those issues were therefore deemed abandoned, and the Commission adopted the ALJ's determinations. See 19 C.F.R. 210.43(b); 68 Fed. Reg. at 70,036.

were not essential to that activity.[4] Pet. App. 5e-6e. The Commission reached the same conclusion under the rule of reason, based on the ALJ's rule-of-reason analysis and findings as to the alleged tying arrangement. *Id.* at 6e.

In reaching those conclusions, the Commission found that Philips possessed the market power required by 35 U.S.C. 271(d)(5) for a finding of patent misuse by tying. Pet. App. 37e. The Commission identified the "relevant market for analyzing market power" as "the United States market for licensing the essential U.S. patents for the manufacture of CD-R/RW discs in compliance with Orange Book standards." *Id.* at 35e. Relying on the ALJ's findings, the Commission concluded that Philips had market power in that market because

> there are no close substitutes for CD-R/RWs [C.A. App. 313-317]; the relevant market for licensing essential CD-R/RW patents is coextensive with the relevant product market for CD-R/RWs because "manufacturers are constrained to enter into those licenses in order to make such unique products" [C.A. App. 319-320]; and licenses to at least some of the Philips patents are essential to the manufacture of CD-R/RWs [C.A. App. 326].

Id. at 37e.

The Commission took no position on the ALJ's other patent-misuse conclusions, *viz.*, that (1) the asserted patents were unenforceable for patent misuse per se

---

[4] Although the ALJ had identified twelve patents included in the package license as nonessential to manufacture CD-Rs or CD-RWs according to Orange Book standards, C.A. App. 349-366, the Commission took no position on the status of eight of those patents, including the Lagadec patent, Pet. App. 68e-69e.

based on theories of price fixing and price discrimination, and (2) the royalty-rate structure of the CD-R/RW patent pools was illegal on a rule-of-reason analysis. Pet. App. 6e nn.3-4, 69e.

4. The court of appeals reversed and remanded. Pet. App. 1d-42d (*Philips I*).[5] As relevant here, the court sustained the Commission's finding, "[b]ased on detailed analysis by the [ALJ]," that Philips has market power in the relevant market ("the market for the tying product," 35 U.S.C. 271(d)(5)). Pet. App. 13d. Focusing on "the situation in the late 1990s, when the parties entered into the agreements at issue in this case," the court of appeals agreed with the Commission's finding that Philips had market power because "[a]t that time, according to the administrative law judge's well-supported finding, compact discs had become unique products [with] no close practice substitutes." *Id.* at 14d (internal quotation marks omitted; second set of brackets in original).

The court of appeals reversed the Commission's per se and rule-of-reason tying analyses, however, as legally and factually flawed. The court concluded that per se treatment was inappropriate because a tying arrangement (such as the package license here) that does not impose any requirement on the customer—such as "compel[ling] the customer to use the [tied] technology" and forgo a competitor's substitute technology—is "not anticompetitive in the way that a compelled purchase of a tied product" had been found to be in prior decisions applying a per se rule. Pet. App. 22d. On the facts, the court of appeals held that the Commission had erred in finding the anticompetitive effect in the tied market re-

[5] Because there are printing errors in the pagination of Appendix D to the petition, this brief refers to that appendix as if it were consecutively paginated.

quired by per se tying law. The court explained that "the evidence did not show that there were commercially viable substitutes for [the nonessential patents identified by the Commission]." *Id.* at 33d. That same factual error, the court held, infected the Commission's rule-of-reason analysis. *Id.* at 38d-41d. The Commission's analysis also failed, in the court's view, to take sufficient account of the relative efficiency of package licensing over single-patent licensing. *Id.* at 41d. The court remanded for the Commission to "address all of the [other] issues presented by the administrative law judge's decision." *Id.* at 42d.

5. On remand, the Commission invited briefing on how it should address the ALJ's patent-misuse determinations on which the Commission had not previously taken a position. In response, petitioners briefed numerous patent-misuse theories. See C.A. App. 6801-6911 (petitioners' submission). No party argued to the Commission, however, that Philips and Sony had agreed not to license the Lagadec patent outside the Orange Book package license for uses that could compete with Orange Book-compliant CD-R/RWs. The Commission rejected all the proffered patent-misuse theories and found that Philips was entitled to Section 337 relief. Pet. App. 1c-158c.

a. The Commission rejected petitioners' argument that "Philips committed patent misuse per se by combining with its horizontal competitors to fix the price of patent licenses in the relevant markets (*i.e.*, the markets for licensing essential CD-R and CD-RW U.S. patents) at anti-competitive levels." Pet. App. 28c. The Commission found no evidence that the patents in the package licenses "cover technologies that are close substitutes." *Id.* at 29c (quoting United States Dep't of Justice & Fed.

Trade Comm'n, *Antitrust Guidelines for the Licensing of Intellectual Property* § 5.1 Example 9 (1995) (*Antitrust Guidelines*)). Consequently, the Commission concluded, "the joint package licenses have *not* been shown to be 'the joint marketing of *competing* patent rights' that 'constitute[] horizontal price fixing and could be challenged as a per se unlawful horizontal restraint of trade.'" *Ibid.* (quoting *Antitrust Guidelines* § 5.1 Example 9) (emphasis added by the Commission) (brackets in original). In turn, "[b]ecause the patents have not been shown to be competing, the pool royalty rate set by Philips and its co-licensors is not a 'pricing agreement between competing entities with respect to their competing products.'" *Ibid.* (quoting *Texaco Inc.* v. *Dagher*, 547 U.S. 1, 6 (2006)).

With regard to the Lagadec patent in particular, the Commission concluded that the record "does not support a finding that the Lagadec * * * patent competes with the [Raaymakers] patents." Pet. App. 32c. The Commission noted with approval that the ALJ had credited testimony that the Lagadec approach is prone to errors and "did not provide a scheme that would work and was reliable." *Id.* at 32c n.19. The Commission further found that "even if Lagadec is a substitute technology for the [technology disclosed in the Raaymakers patents], it is not a substitute technology that can be used to manufacture Orange Book compliant CD-R/RW discs." *Id.* at 32c. The Commission added that petitioners had "pointed to no evidence that the Lagadec approach is a commercially viable technological alternative to the technology of [the Raaymakers] patents. Moreover, the commercial viability of a method that is prone to errors, unreliable, and unworkable is doubtful." *Id.* at 32c n.20.

The Commission also rejected petitioners' contention (see C.A. App. 6858-6859 (petitioners' submission)) that Philips and Sony were potential horizontal competitors who "chose not to compete." Pet. App. 32c; see *id.* at 32c-36c. It found that petitioners had "not pointed to evidence that establishes that, absent the pooling arrangements, the pool licensors would have competed in the technology licensing market." *Id.* at 35c. The Commission also noted evidence that Philips and Sony had decided to work together for technical reasons. *Id.* at 34c n.21.[6]

b. The Commission also found no patent misuse under the rule of reason, rejecting each theory of anticompetitive effect found by the ALJ, advanced by petitioners, or argued by the Commission's investigative attorney.

i. The Commission rejected the ALJ's determination that the pricing and terms of the package licenses constituted patent misuse on a price-fixing theory, finding that the evidence did not establish the requisite anticompetitive effect. See Pet. App. 79c-81c (rejecting ALJ's rationale that the royalty rate was higher than industry norms); *id.* at 81c-83c (rejecting ALJ's rationale that the royalty rate for the package was higher than the sum of the royalties under separate licenses); *id.* at 83c-84c (rejecting petitioners' argument based on anticompetitive effects in the market for CD-R/RW discs). The Commission also reversed the ALJ's find-

---

[6] The Commission also rejected per se patent-misuse theories premised on effects in the market for CD-R/RW discs, including price fixing through setting the level of patent licensing royalties (Pet. App. 36c-45c), price fixing through agreements with individual manufacturers (*id.* at 46c-62c), and price discrimination through certain royalty-free sales of discs (*id.* at 62c-68c).

ings of anticompetitive effect from inclusion of nonessential patents in the package licenses because the evidence did not meet the standard articulated by the court of appeals in *Philips I*. See *id.* at 110c-114c.

ii. The Commission addressed the Lagadec patent at several points in its analysis of other theories of anticompetitive effects. The Commission's investigative attorney argued that tying the Lagadec patent resulted in anticompetitive royalty levels—that is, that the price for the pool license was higher than the combined prices the pool licensors would have been able to obtain if each licensor had offered its patents separately. The Commission agreed with Philips that including an unwanted patent would not allow the seller to increase the royalty for the package above the profit-maximizing price for the tying patents. Pet. App. 136c (citing 9 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 1706b2 at 64 (2d ed. 2004)). It further found that "the premise of the [investigative attorney's] argument, *viz.*, that the Lagadec * * * patent cannot be used to make an Orange Book compliant CD, is fatal to his rule of reason tying claim." *Ibid.*

The Commission also rejected (Pet. App. 139c-142c) the investigative attorney's theory that tying the Lagadec patent foreclosed competition from Sony by providing a "lifeline for the royalty payments to Sony for CD-R/RWs sold in the United States" and "thus secur[ing] Sony's adherence to the CD-R/RW system and the Orange Book standard," C.A. App. 6758, 6765 (investigative attorney's submission). The Commission found no record evidence supporting the argument that Philips had "forestall[ed] competition from Sony" in that way. Pet. App. 139c-142c. The Commission also rejected spe-

cific inferences the investigative attorney had drawn, as well as certain remarks offered by the ALJ. See, *e.g.*, *id.* at 141c n.63 (cited testimony provides "inadequate support for the [investigative attorney's] inference that Philips included Sony in the pool not because Sony brought anything necessary to the CD-R/RW technology, but rather because Sony is a major player in the industry, whose cooperation Philips wanted") (internal quotation marks omitted); *id.* at 139c n.62 (noting that "the ALJ failed to articulate any basis for his remark that the inclusion of the Lagadec patent 'in the pool appears to be an attempt to forestall digital approaches to achieving what the Philips analog technology has achieved' [C.A. App. 353-354]").

The Commission also rejected petitioners' similar argument that Philips had prevented competition from Sony by including the Lagadec patent in the pools with the Raaymakers patents. Pet. App. 114c-117c. Petitioners contended that by tying Sony's nonessential patents "into the CD-R Pool License, Philips enabled Sony to collect vast royalties, thereby ensuring that Sony would not develop an alternative, competing product with its non-essential patents." C.A. App. 6910. The Commission found, however, that petitioners had "not identified evidence establishing that, if Sony's * * * patents were not included in the licenses, Sony likely would have developed technologies that competed against the Orange Book standard in a relevant market." Pet. App. 116c n.51. The Commission cross-referenced its rejection of petitioners' price-fixing theories, reiterating that "the record does not support a finding that the Lagadec * * * patent competes with the [Raaymakers] patents." *Id.* at 116c-117c.

iii. Petitioners also advanced, and the Commission rejected, various other theories of anticompetitive effect unrelated to the Lagadec patent. See C.A. App. 6889-6890 (petitioners' contention that discriminatory pricing, by allowing "preferred manufacturers (who don't pay royalties)" to increase market share, had anticompetitive effect); Pet. App. 85c-90c (Commission rejecting same); C.A. App. 6890-6891 (petitioners' contention that package licenses improperly obligated licensees to continue to pay royalties after certain patents expired); Pet. App. 90c-94c (Commission rejecting same); C.A. App. 6892 (petitioners' contention that narrow package license grant's restriction that licensees may use the subject patents only to practice the Orange Book standards had anticompetitive effect); Pet. App. 94c-95c (Commission rejecting same).

6. A divided panel of the court of appeals affirmed in part, vacated in part, and remanded. Pet. App. 1b-59b (*Philips II*). Represented by new counsel, petitioners challenged the Commission's decision on three grounds, each related to the Lagadec patent: (1) that inclusion of the Lagadec patent in the CD-R/RW pool was an unlawful tying arrangement; (2) that the Lagadec patent was nonessential to the package license, and its inclusion was therefore misuse per se under *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100 (1969); and (3) that including the Lagadec patent in the CD-R/RW pool with the Raaymakers patents was a horizontal price-fixing agreement illegal per se and under the rule of reason.

a. The panel unanimously affirmed the Commission's rejection of Princo's tying argument, although on a ground not adopted by the Commission. Pet. App. 20b-26b, 49b-50b. The panel majority concluded that

"inclusion of the Lagadec patent in the patent pool did not give rise to an illegal tying arrangement, because Claim 6 reasonably might be necessary as a blocking patent to the Orange Book standard," *id.* at 23b-24b—that is, a patent "that at the time of the license an objective manufacturer would believe reasonably might be necessary to practice the technology at issue," *id.* at 21b. The panel majority rejected petitioners' *Zenith* argument on the same reasoning. *Id.* at 26b-27b.

The panel majority nevertheless concluded that the Commission had erred in failing to address whether Sony and Philips had agreed not to license Sony's Lagadec patent in a manner that would allow its development as competitive technology. Pet. App. 27b-29b (citing *id.* at 31c-32c). The panel majority stated that "[t]he Commission did not determine that Lagadec was fundamentally incapable of being commercialized as part of an alternative standard, but merely that it was not workable within the context of existing Orange Book technology." *Id.* at 37b. The panel majority also discounted the relevance of expert testimony that the Lagadec approach is "prone to errors, unreliable, and unworkable," *id.* at 32c n.20, because that evidence was offered "during testimony related to the *validity* of the Raaymakers * * * patents, not in the context of whether Lagadec could have been a competitive alternative to the Orange Book technologies." *Id.* at 37b n.13.

The panel majority therefore would have remanded to the Commission to determine "in the first instance" the legal standard under the rule of reason for invoking patent misuse in these circumstances and whether the evidence satisfies the standard. Pet. App. 38b, 40b. The panel majority would also have directed the Commission to determine in the first instance "whether there was in

fact an agreement between Philips and Sony to prevent the licensing of Lagadec as a competitor to the Orange Book." *Id.* at 41b. It nevertheless "emphasize[d] that the burden of proving misuse, and the corresponding risk of having made an insufficient record, lies with [petitioners]." *Id.* at 45b.

b. Judge Bryson would have affirmed the Commission's final determination. He concurred in the panel majority's result with respect to petitioners' tying and *Zenith* claims. Pet. App. 48b-51b. Judge Bryson agreed with the Commission that "the evidence failed to show that the Lagadec and Raaymakers technologies were substitutable." *Id.* at 52b. He therefore concluded that petitioners could show no anticompetitive effect from a putative agreement between Philips and Sony "not to allow Lagadec to be licensed outside the Orange Book." *Id.* at 59b; see *id.* at 52b-59b. Judge Bryson added that "[a]lthough * * * the Commission did not address the question whether Philips and Sony agreed not to license Lagadec as a competitor to the Orange Book, it is not clear that [petitioners] squarely presented that argument to the Commission." *Id.* at 59b.

c. All parties petitioned for rehearing or rehearing en banc. The Commission argued, *inter alia*, that petitioners had never alleged during the agency proceedings that Philips and Sony had agreed not to license the Lagadec patent as competitive technology to the Orange Book, and that the Commission therefore had not erred in failing to address the possible legal consequences of such an agreement. The court of appeals granted the petitions for rehearing en banc filed by Philips and the

Commission, denied petitioners' petition for rehearing, and vacated the panel's decision. Pet. App. 3g.[7]

7. The en banc court affirmed the Commission's determination that Philips was entitled to Section 337 relief. Pet. App. 1a-88a.

a. The Commission's primary submission to the en banc court of appeals was that petitioners had never presented to the Commission, and had thus forfeited, any misuse defense based on a putative agreement between Philips and Sony to suppress the Lagadec technology.[8] The court summarily declined to address the forfeiture issue. See Pet. App. 14a-15a.

b. On the merits, the court of appeals held that the putative agreement restricting the availability of Sony's Lagadec patent would not constitute misuse of Philips's patents. Pet. App. 15a-46a.

i. The court of appeals first determined that an allegation of patent misuse must rest on an exercise of "patent leverage," specifically, "the use of the patent power to impose overbroad conditions on the use of the patent in suit that are 'not within the reach of the monopoly granted by the Government.'" Pet. App. 27a (quoting *Zenith*, 395 U.S. at 136-138). The court concluded that the putative agreement to restrict the availability of the Lagadec patent "does not leverage the power of a patent to exact concessions from a licensee that are not fairly

---

[7] The en banc court ultimately reinstated the panel opinion as to petitioners' misuse arguments that the panel had unanimously rejected. Pet. App. 15a n.1.

[8] Petitioners' and the Commission's en banc briefs were filed simultaneously. The court of appeals permitted petitioners to file a response to the Commission's en banc brief, but denied the Commission's motion to file a supplemental brief responsive to either of petitioners' briefs.

within the ambit of the patent right," and it accordingly found no misuse of Philips's patents. *Id.* at 30a, 32a.

ii. The court of appeals also rejected petitioners' patent-misuse defense on the separate ground that petitioners had failed to show that the putative agreement to suppress the Lagadec technology was anticompetitive. Pet. App. 33a-46a. The court declined petitioners' suggestion—first made at the en banc stage of this case—to overrule Federal Circuit decisions holding that such a showing was required to find misuse. The court reaffirmed that "[t]o sustain a misuse defense involving a licensing arrangement not held to have been per se anticompetitive by the Supreme Court, a factual determination must reveal that the overall effect of the license tends to restrain competition unlawfully in an appropriately defined relevant market." *Id.* at 33a (quoting *Windsurfing Int'l, Inc.* v. *AMF, Inc.*, 782 F.2d 995, 1001-1002 (Fed. Cir.), cert. denied, 477 U.S. 905 (1986)).

Applying that test, the court of appeals rejected petitioners' contention that the putative agreement was a naked restraint of trade with no procompetitive justification. Pet. App. 34a-38a. The court reasoned that "research joint ventures such as the one between Philips and Sony can have significant procompetitive features, and it is now well settled that an agreement among joint venturers to pool their research efforts is analyzed under the rule of reason." *Id.* at 34a (citing *Addamax Corp.* v. *Open Software Found., Inc.*, 152 F.3d 48, 52 (1st Cir. 1998)). It explained that "[t]he 'ancillary restraints' that are often important to collaborative ventures, such as agreements between the collaborators not to compete against their joint venture, are also assessed under the rule of reason." *Id.* at 37a (citing, *inter alia*, *Rothery Storage & Van Co.* v. *Atlas Van Lines, Inc.*,

792 F.2d 210, 214, 223-230 (D.C. Cir. 1986), cert. denied, 479 U.S. 1033 (1987)). The court rejected, as unsupported by the record, petitioners' argument that the putative agreement was not "ancillary" to a collaborative joint venture. *Id.* at 38a n.7.[9]

The court of appeals began its rule-of-reason analysis by noting the question the panel had focused on: "whether Sony and Philips agreed to suppress competition between the technology represented by the Orange Book standard and technology that fell outside the Orange Book standard, i.e., the Lagadec digital encoding technology." Pet. App. 39a. The court recognized that "[t]he Commission did not answer that question because the question was never squarely presented to it." *Ibid.* The court explained, however, that it was not required to decide that question "because the Commission's factual findings make it clear that even if there was such an agreement, it did not have the effect of suppressing potentially viable technology that could have competed with the Orange Book standards." *Ibid.*

The court of appeals explained that the Commission's decision was supported by "a series of specific findings" in that regard. Pet. App. 39a. First,

---

[9] For related reasons, the court of appeals rejected a "quick look" approach to the putative agreement. It acknowledged that such an analysis "might be justified if the joint venture in this case were a sham, or if the alleged agreement were a naked restraint, i.e., not reasonably necessary to achieve the efficiency-enhancing benefits of the joint venture." Pet. App. 45a (citing *Major League Baseball Props., Inc.* v. *Salvino, Inc.*, 542 F.3d 290, 338 (2d Cir. 2008) (Sotomayor, J., concurring)). The court found, however, that the joint venture in this case was not a sham and that the putative agreement was not a naked restraint. *Ibid.*

> the Commission noted that the evidence before the administrative law judge showed that the Lagadec technology "does not work well according to the Orange Book standards." The Commission added that the administrative law judge "credited testimony that the Lagadec approach is prone to errors and 'did not provide a scheme that would work and was reliable.'"

Id. at 39a-40a. The court further recognized that those findings were not limited to the unsuitability of using the Lagadec technology to produce Orange Book-compliant discs:

> [A]s is clear from the testimony on which those findings were based, the findings applied more generally to the technical problems presented by the Lagadec technology. The administrative law judge referred to testimony by Philips's expert explaining that there is "a real problem" with the Lagadec digital approach and that "it is very difficult to carry out a decoding of this particular approach." The expert added that "[a]s a result, Philips and Sony dismissed the Lagadec approach because this is a very difficult problem to solve and Lagadec just did not provide a scheme that would work and was reliable. . . . [F]rom basic physics, you can just see that this is not a good solution, and it really wouldn't work well."

Id. at 40a (brackets in original).

Second, based on the Commission's findings and the testimony of several witnesses that Philips "partnered with Sony for technical reasons," the court of appeals rejected petitioners' argument that the pooling arrangement was not "designed as a joint technical project" between Philips and Sony. Pet. App. 41a. The court also

observed that the pooling arrangement was not designed "as a means of allowing Philips to share its royalties with Sony in exchange for Sony's agreement not to compete against the Orange Book standard." *Ibid.*

Third, the court of appeals noted the Commission's observation that "there was no evidence in the record that Sony would have entered and survived to become a significant competitive force in the CD-R/RW market with the Lagadec technology." Pet. App. 41a (internal quotation marks omitted). The court also found no "evidence that any potential licensee might develop the Lagadec technology." *Id.* at 42a. The court explained that the Commission's findings "wholly undermine [petitioners'] contention that this is a case in which the patents in suit have been used as part of an overall horizontal agreement with the effect of keeping a viable competitor out of the relevant market." *Id.* at 43a.

c. Judges Prost and Mayer concurred in part. Pet. App. 48a-51a. They would have affirmed the Commission's decision on the ground that petitioners had "failed to meet [their] burden of showing that any agreement regarding the Lagadec patent had anticompetitive effects." *Id.* at 48a-49a. They therefore would have "reserve[d] judgment on the precise metes and bounds of the patent misuse doctrine." *Id.* at 51a.

d. Judges Dyk and Gajarsa—who had constituted the panel majority—dissented. Pet. App. 52a-88a. They expressed the view that the en banc court had "emasculate[d] the doctrine [of patent misuse] so that it will not provide a meaningful obstacle to patent enforcement." *Id.* at 53a. They would have largely adhered to their prior disposition of the case.

ARGUMENT

This case arises on judicial review of an order of the International Trade Commission that excluded petitioners' products from this country on the ground that they infringed patents held by respondent Philips. But the question presented by petitioners in this Court—whether an agreement by Philips and Sony to suppress the Lagadec technology would constitute misuse of Philips's patents—was one "[t]he Commission did not answer * * * because the question was never squarely presented to it." Pet. App. 39a. Petitioners' failure to raise their current argument in the agency proceedings is a sufficient basis for affirming the Commission's determination, and it is a compelling reason to deny further review.

Forfeiture aside, petitioners face a daunting task. To prevail, they must show not only that the court of appeals erred in recognizing a "leveraging" requirement in patent-misuse law, but also that the court should have ignored the Commission's extensive findings that the Lagadec approach lacked both technical feasibility and commercial potential—findings that cast overwhelming doubt on the proposition that Lagadec's putative suppression had anticompetitive effect. Such a tenuous case is an unsuitable vehicle for exploring the intricacies of patent-misuse law.

This case is a poor vehicle for other reasons as well. A case presenting both a patent-misuse defense and an antitrust counterclaim would be a more suitable vehicle for this Court's consideration of the interplay between antitrust principles and the patent-misuse doctrine. And the last of Philips's Orange Book patents expires in approximately one year, at which point the Com-

mission's exclusion order that petitioners challenge will cease to have effect. Further review is not warranted.

1. Petitioners' question presented is whether Philips misused its patents by agreeing with Sony to suppress the Lagadec patent as competitive technology to the Orange Book, by refusing to license it outside the CD-R/RW package licenses for purposes that could compete with the Orange Book standard. Pet. i. Despite offering numerous theories of patent misuse in proceedings below, petitioners never made that suppression argument to the Commission, nor did the Commission decide the issue. The proceedings in the court of appeals, however, arose on judicial review of the Commission's decision ordering petitioners' products excluded from this country. Because petitioners seek a judicial decree overturning that agency decision, based on a theory of patent misuse that was never presented to the Commission, their argument founders on the bedrock requirement that "objections to the proceedings of an administrative agency [must] be made while it has opportunity for correction in order to raise issues reviewable by the courts." *United States* v. *L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 37 (1952).

a. Nowhere in the petition do petitioners identify where their current claim was pressed on or passed upon by the Commission. The petition instead refers for factual support only to a "non-compete agreement [between Philips and Sony that] was made in 1993." Pet. 5 (citing Pet. App. 84a). That may be a reference to a 1993 letter that was the subject of some briefing by petitioners and Philips to the court of appeals panel and the en banc court. See Pet. C.A. Panel Br. 41; Philips C.A. Panel Br. 39-40 & n.17; Pet. C.A. Panel Reply 12-14; Pet. C.A. En Banc Br. 20-25; Philips C.A. En Banc Reply 10-

13, 15. But there is nothing remotely comparable in petitioners' submission to the Commission on remand from *Philips I*. And even the panel majority in *Philips II* found the record so "unclear" and had such "question[s] as to how to interpret" the letter that it would have remanded to the Commission for factual findings. Pet. App. 42b-45b.

On remand from *Philips I*, petitioners argued that "Philips used its market power and combination with its horizontal competitors * * * to unreasonably restrain competition." C.A. App. 6858 (capitalization omitted). That argument did not embrace a suppression theory. Although petitioners asserted in passing that "[Philips's] horizontal competitors' patents [were] locked up in one non-negotiable, mandatory patent pool license," *ibid.*, they did not allege the existence of any agreement not to negotiate licenses outside the package licenses, and they did not even mention the Lagadec patent. Rather, petitioners argued that "Philips and Sony developed CD-R/RW formats around their patented technologies, and codified mandatory use of their patents in the Orange Book"; that the two companies "agreed to jointly license their patents" in a single mandatory pool license; and that "[l]icensees were forced to take a license under patents they did not want—and did not need." *Id.* at 6859. Those allegations, if true, would not establish that Philips and Sony had agreed not to license the Lagadec patent as a competing technology to the Orange Book.

Petitioners' price-fixing argument likewise did not rest on a suppression theory. That price-fixing theory depended on the effect of the pool arrangement on the price for the package licenses and on the price of products produced using those licenses. See C.A. App. 6864-

6876. That argument did not logically imply that the Lagadec technology was suppressed.

Nor did petitioners' tying arguments amount to a claim of suppression. Petitioners' theory before the Commission was that, unless Sony's "non-essential" patents (*viz.*, the Lagadec patent and one other patent) were included in the CD-R/RW pools, Sony would not share in the pool royalties. See C.A. App. 6898-6899, 6903. Petitioners argued that by tying those "non-essential" patents into the pools, Philips gave Sony an economic incentive not to compete with Philips. See *id.* at 6887-6888, 6898, 6903. While that theory is not inconsistent with a suppression theory, petitioners did not allege and did not attempt to prove an agreement between Philips and Sony not to license the Lagadec patent (or any other patent) as competing technology to the Orange Book.[10]

Petitioners' argument before the Commission focused on the purported anticompetitive effects of an agreement between Philips and Sony that the Lagadec patent *would* be included *in* the CD-R/RW package licenses. Their argument in this Court, by contrast, is that Philips and Sony engaged in patent misuse by agreeing that the Lagadec patent *would not* be available *outside* the CD-R/RW package licenses for purposes that could compete with the Orange Book standard. Theories predicated on the existence of the former agreement are not sufficient to preserve for review

---

[10] In arguing that they presented a suppression claim during the agency proceedings, petitioners have previously cited a restrictive-use argument they made to the Commission on remand from *Philips I*. See C.A. App. 6892. The Commission determined, however, that the argument had been waived. See Pet. App. 95c. In any event, that argument does not mention Sony or the Lagadec patent.

a theory based upon the existence of the latter agreement. Nor did petitioners separately argue to the Commission any theory of per se patent misuse based on an agreement to suppress Sony's Lagadec patent. Those failures are especially glaring given the multiple appeals, extensive briefing to the Commission, and years of litigation involved in this case, during which the Commission has addressed a dozen or more theories of patent misuse, none of them fairly embracing the theory on which petitioners now seek this Court's review.

b. Nor did the Commission actually address a suppression argument. The court of appeals panel majority believed that the Commission had simply sidestepped the question whether Philips and Sony had agreed to suppress the Lagadec technology, on the view that such an agreement would be legally irrelevant. See Pet. App. 27b-29b (citing *id.* at 31c-32c). But the Commission analysis cited by the panel majority related to whether the patents in the pool competed in the first instance, and thus whether the pool royalty rate was a pricing agreement between competing entities with respect to their competing products. The Commission also rejected petitioners' argument that Philips and Sony were potential horizontal competitors who had chosen not to compete, but in so doing, the Commission did not purport to address an argument that the putative competitors had agreed to suppress one of their technologies.

2. In any event, "the Commission's factual findings make it clear that even if there was such an agreement, it did not have the effect of suppressing potentially viable technology that could have competed with the Orange Book standards." Pet. App. 39a. As a matter of "basic physics," the evidence showed that the Lagadec technology was fraught with errors and unreliable. *Id.*

at 39a-40a. The record evidence and a variety of Commission findings indicate that, even if petitioners demonstrated an agreement to suppress the Lagadec technology, such an agreement could not have had any anticompetitive effects:

- Referring to the Lagadec technology, the Commission concluded that "the commercial viability of a method that is prone to errors, unreliable, and unworkable is doubtful." Pet. App. 32c n.20.
- The Commission concluded that the record "does not support a finding that the Lagadec * * * patent competes with the [Raaymakers] patents." Pet. App. 32c.
- The Commission determined that petitioners had "pointed to no evidence that the Lagadec approach is a commercially viable technological alternative to the technology of [the Raaymakers] patents," Pet. App. 32c n.20, nor had they "pointed to evidence that establishes that, absent the pooling arrangements, the pool licensors would have competed in the technology licensing market," *id.* at 35c.[11]
- As the court of appeals recognized, "there was no evidence in the record that Sony would have entered and survived to become a significant competitive force in the CD-R/RW market with the

---

[11] The Commission's observations about the state of the record are relevant even if Philips should have borne the burden of proof on certain issues, see p. 29, *infra*, because petitioners still had the incentive to bring favorable evidence on a contested issue to the Commission's attention, yet did not do so.

Lagadec technology." Pet. App. 41a (internal quotation marks omitted).

- The Commission's findings were not limited to Lagadec's "commercial viability"; rather, they "addressed both technical feasibility and commercial potential, and [the Commission] found the Lagadec approach lacking in both respects." Pet. App. 40a-41a.
- For example, the Commission noted with approval that the ALJ had credited testimony that the Lagadec approach is prone to errors and "did not provide a scheme that would work and was reliable." Pet. App. 32c n.19.
- Petitioners themselves emphasized to the Commission that expert testimony demonstrated "that Philips considered the *digital* modulation approach of Lagadec and the *analog* frequency modulation of [the Raaymakers] patents, and decided to go with the analog modulation approach because the Lagadec approach would not work with a CD-R/RW system." C.A. App. 6902 (petitioners' submission).
- The Commission's "findings were not limited to the unsuitability of using Lagadec to produce Orange-Book-compliant discs." Pet App. 40a. Rather, "as is clear from the testimony on which those findings were based, the findings applied more generally to the technical problems presented by the Lagadec technology." *Ibid.*
- The ALJ's findings of fact show in detail why the Lagadec method lacked potential as a technological alternative to the approach adopted in the

Orange Book.[12] Those include findings that the Lagadec method produces "low-frequency components [that] cannot be filtered out" and that "interfere[] with the velocity control." C.A. App. 470-471. The Lagadec approach is "prone to errors," and it "does not leave room for error detection encoding in the system." *Ibid.*; see Pet. App. 40a.

Petitioners could, in theory, prevail despite those factual obstacles if this Court departed radically from the court of appeals' articulation of patent-misuse law. Thus, although petitioners did not make this argument before the Commission, they now advocate a test for finding patent misuse that would not depend on the presence of anticompetitive effects. See Pet. 21-25. Such a test would depart significantly from the patent-misuse doctrine to which the Federal Circuit has "consistently adhered." Pet. App. 33a (declining to overrule *Windsurfing Int'l, Inc.* v. *AMF, Inc.*, 782 F.2d 995, 1001-1002 (Fed. Cir.), cert. denied, 477 U.S. 905 (1986)).[13]

Petitioners alternatively propose a test that would require Philips to demonstrate the absence of anticompetitive effects. See Pet. 32-34; see also Pet. App. 42a. The Commission's initial and remand decisions do not speak directly to that proposal (because that standard was never proposed to the Commission). But even if the

---

[12] The speculation about the Lagadec technology in the en banc dissent (Pet. App. 88a) is contrary to the ALJ's findings of fact, which were adopted by the Commission in 2003, and which petitioners failed to dispute at the appropriate time, see note 3, *supra*.

[13] Indeed, in their submission to the Commission on remand, petitioners relied on *Windsurfing* in articulating the standard that the Commission should apply. C.A. App. 6881-6882; see Pet. App. 71c-72c.

Court adopted petitioners' legal theory, there would still be no reason to think that petitioners could prevail on the facts because the Commission's emphatic findings suggest that Philips could carry the burden of demonstrating the absence of anticompetitive effect.

3. Two other features of this case make it a particularly unattractive vehicle for addressing the question petitioners would present. First, the case arises from petitioners' challenge to a decision of the International Trade Commission, which cannot hear an accused infringer's counterclaim under the antitrust laws. See 19 U.S.C. 1337(c). If this Court views clarification of the patent-misuse doctrine as desirable, the Court would be better served to hear a case originating from a district court in which the defendant asserted both a patent-misuse defense and an antitrust counterclaim, because a case squarely raising both issues would facilitate the Court's examination and articulation of the appropriate relationship between the two concepts. Although petitioners correctly observe that proof of antitrust standing and of entitlement to damages can be obstacles to such a counterclaim, Pet. 31, they do not contend that such cases never arise.

Second, without an antitrust counterclaim or a claim for patent-infringement damages (which the Commission is not empowered to award, see 19 U.S.C. 1337(d)), the only practical consequence of the en banc court's decision is to maintain in effect the Commission's prospective exclusion from this country of products that infringe Philips's patents. Here, the Commission's remedial orders provide such relief—in the form of a general exclusion order and four cease-and-desist orders—during the remaining terms of the patents. But five of the six Philips patents expired during the pendency of

this proceeding, and the Commission understands that the sixth will expire on May 23, 2012. On that date, the Commission's orders will expire and petitioners' products can be imported into the United States. Thus, even if this Court granted the petition and reversed the judgment of the court of appeals, the agency orders that petitioners challenge would likely expire of their own force before the completion of the necessary proceedings on remand.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

NEAL KUMAR KATYAL
Acting Solicitor General

JAMES M. LYONS
General Counsel

WAYNE W. HERRINGTON
Assistant General Counsel

CLARA KUEHN
Attorney
International Trade Commission

APRIL 2011